

# **Contract farming and standards for a better market integration: two case studies in Costa Rica<sup>1</sup>**

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## **1) Introduction (who and where)**

Integration to both domestic and international dynamic markets is still crucial for medium and small-sized producers in emerging economies. This market integration is determined by several endogenous and exogenous conditions with respect to producers themselves, which yields different levels of success within a specific sector. Transaction costs, price uncertainty, and lack of confidence along the agri-chain are some of the structural problems that hinder a better integration. As the agricultural policy over the past 20 years has been strongly biased toward the promotion of export-oriented cash crops, with little attention to important food crops for the Costa Rican population (i.e. rice, beans, horticulture in general). In the long term, food security in Costa Rica may be endangered by transaction costs and lack of a real public policy in this matter, while the country may progressively depend on the import of partially or totally processed food.

Contract farming and the implementation of grades and standards (G&S) are two important instruments aimed to gain a better market integration. Contract farming has been mentioned in the literature as an instrument to considerably reduce transaction costs, and provide a better institutional environment for integration small and medium-sized producers into the market. On the other hand, G & S becomes an important complement of contracts for compliance of several clue issues, such as regularity and confidence on extrinsic products' characteristics (bio-security, environmental effects), and improvement of social conditions at primary production level. Under certain conditions, both instruments can be part of a successful strategy to integrate producers into dynamic chains and assure sustainable production. Nevertheless, synergies and competition between contract and G&S strategy has been poorly documented.

## **2) Objective of the action (what)**

In this presentation we analyze two different agri-chains with different market orientations: chayote (*Sechium edule* Sw.) for both domestic and international markets; and pineapple (*Ananas sativus* (Lindl) Schult.) oriented toward international market. In the first case, G&S are less developed than in the second case, while in both cases they manage verbal procurement contracts. Moreover, both sectors are subject of low public regulation and receive little support from the Government. With an historical perspective, we analyze the level and configuration of market integration in each case and the role played by contracts and G&S in the sustainability

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of this integration. We focus on successful experiences and points out policy recommendations for further improvements.

### **3) Implementation process (how)**

For a successful implementation of both instruments (contracts and G&S) producers would require certain stable market relationship with a export/processing buyer, where flows of information regarding product specification goes from the buyer to the producer, while in the opposite direction the produce is delivered according the quality conditions (G&S), at the required volume and timing (contracts). A successful contractual relationship should be a “play of two”, where the transference of risk, rights and obligations would conduct to a stable market integration.

### **4) Key points of success**

- Technical assistance provided by the buyer is the most successful mechanism to assure the right information goes to produces and monitor compliance of contracts and G&S. Important issues here are to gain maximum product coordination and avoid producers' default
- Successful contracts should function as provider of insurance and incentives to producer, which in turn should yield effects in terms of equity (access to markets), and efficiency and sustainability of the market relationship.
- Attitude, transparency, frequency and loyalty are key important issues to sustain a contractual relationship between two parties.

### **5) Conclusions and lessons learned from the experience.**

Producers do not directly participate in the design and/or implementation of contract schemes and G&S. Usually the definition of both instruments takes place at middle and final stages in the agri-chain (export companies in case of contracts and supermarkets in case of G&S).. Then, the definition goes backwards until the first step or where the primary production takes place. If small and medium-sized producers are usually considered as price takers, we can say they are also “market conditions takers”. Contractual systems are important for providing security, incentives and information to producers. These functions yield certain effects on producers' decisions regarding resource allocation and supply chain integration. G&S are proven to be important for accessing international dynamic markets and enforce already existing environmental and social legislation. Nevertheless, both instruments require continuous revision and policy support to make them more efficient, effective, and manageable by small and medium-sized producers.